



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Date: June 6, 2013
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4942.00-00
4942.03-05

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

Foundation =
Founders =
Founder 1 =
Date =

Dear :

We have considered your request for rulings regarding a qualifying distribution made to a private foundation pursuant to I.R.C. §§ 4942(g)(1) and (3).

Facts:

You are exempt from federal income tax under § 501(c)(3) and are classified as a private foundation under § 509(a). You primarily make grants to other charities. Foundation is exempt from federal income tax under § 501(c)(3), and is classified as a private foundation under § 509(a), and as an operating foundation under § 4942(j)(3). Your Founders created Foundation primarily to receive and administer funds to encourage the study and appreciation of the work and philosophy of Founder 1 and to account for the architectural record of Founder 1's professional career. You and Foundation have the same six trustees, who are the Founders three children and three grandchildren.

Founders constructed a home and studio to hold the documentary archives of Founder 1's professional career. Founders created Foundation and transferred the home and studio to Foundation to preserve them and the grounds on which they are located and to make the archived records available for research and public display. You owned a contiguous half-acre parcel of land (Property) where you built two office buildings and leased them to a professional services firm as office space. In the year under consideration, the trustees decided that they would no longer lease the office buildings to any organization that was not associated with the home and studio. They also agreed to remove the office buildings so that Foundation could show Founder 1's original home and studio in a historically accurate setting, in accordance with Foundation's exempt purpose. You attached to your request for ruling a copy of the trustee's plan to convert Property.

The plan states that your trustees met on two dates, the last one on Date, to discuss the disposition of the Property and, acting on your behalf, agreed to transfer it to Foundation. Next, the trustees, acting on behalf of Foundation, agreed to convert the Property to the same purpose as the home and studio by removing the office buildings and restoring the land to its original state so that Foundation could show Founder 1's original home and studio design in accordance with Foundation's exempt purpose.. The trustees agreed that they would implement their plan by transferring the Property, obtaining an exemption from property tax, arranging for the removal of the office additions, and restoring the grounds. Your quitclaim deed shows that you donated Property to Foundation. You also stated that Foundation applied to the city for exemption of the Property from real property tax and that the city determined that the Property was not subject to property tax, beginning the year after Date. Moreover, you stated that, well before the end of the year after Date, Foundation demolished the office space and began to restore the grounds to their original state.

In your recently submitted letter dated June 3, 2013, you state that the conveyance of the Property by you to Foundation was a qualifying distribution on Date. Also, you represent that "the pass-thru reporting requirements in Treas. Reg. § 53.4942 have been met." In addition, you represent that Foundation's Form 990-PF, Return of Private Foundation or § 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation, for the prior year shows no undistributed income remaining at the end of the year and that Foundation's qualifying distributions for the distribution year far exceed its income.

Rulings Requested:

You requested the following rulings:

1. Your conveyance of Property to Foundation and the conversion of Property to an exempt use in such year constitutes a qualifying distribution by you under § 4942(g)(3) in an amount equal to the fair market value of Property at the date of its conversion to exempt purposes.
2. The conversion of Property to exempt purposes by Foundation occurred on Date.

Law:

I.R.C. § 170(c)(2)(B) provides that for purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of a corporation, trust, or community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.

I.R.C. § 501(c)(3) provides for the exemption from federal income taxation of organizations organized and operated exclusively for charitable and/or educational purposes.

I.R.C. § 4942(a) and (b) impose excise taxes on the "undistributed income" of a private foundation.

I.R.C. § 4942(g)(1) states that the term "qualifying distribution" means (A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in §170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in §4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3), or (B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in §170(c)(2)(B).

I.R.C. § 4942(g)(3) states that for purposes of this section, the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization described in paragraph (1)(A)(i) or (ii) if--(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection(h) as a distribution out of corpus (or would be so treated if such § 501(c)(3) organization were a private foundation which is not an operating foundation), and (B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such organization.

I.R.C. § 4942(h)(1) states that, generally, any qualifying distribution made during a taxable year shall be treated as made (A) first out of the undistributed income of the immediately preceding taxable year (if the private foundation was subject to the tax imposed by this § for such preceding taxable year) to the extent thereof, (B) second out of the undistributed income for the taxable year to the extent thereof, and (C) then out of corpus. For purposes of this paragraph, distributions shall be taken into account in the order of time in which made.

I.R.C. § 4946(a)(1)(A) states, in pertinent part, that the term "disqualified person" means, with respect to a private foundation, a person who is a substantial contributor to the foundation.

I.R.C. § 4946(a)(1)(D) states, in pertinent part, that the term "disqualified person" means, with respect to a private foundation, a member of the family of any individual described in subparagraph (A).

Treas. Reg. § 53.4942(a)-3(a)(1) states that for purposes of § 4942 and the regulations thereunder, the amount of a qualifying distribution of property (as defined in subparagraph (2) of this paragraph) is the fair market value of such property as of the date such qualifying distribution is made.

Treas. Reg. § 53.4942(a)-3(a)(5) states that if an asset not used (or held for use) directly in carrying out one or more purposes described in § 170(c)(1) or (2)(B) is subsequently converted to such use, the foundation may treat such conversion as a qualifying distribution. The amount of such qualifying distribution shall be the fair market value of the converted asset as of the date of its conversion.

Rev. Rul. 78-102, 1978-1 C.B. 379, described a private foundation that made a qualifying distribution for exempt purposes under § 4942(g) of the Code by reason of converting farm land to

an exempt use. In that case, the ruling held that the date of the decision to convert the land to exempt purposes was the date the organization adopted a plan for the exempt use of the property and immediately proceeded to implement it. Accordingly, the date of conversion was the date the organization effectively committed the property to exempt use for purposes of treating the conversion as a qualifying distribution under § 53.4942(a)-3(a)(5).

Analysis and Conclusion:

Ruling 1:

I.R.C. § 4942(a) states that private foundations are required to spend a certain amount of money or property for charitable purposes each year, which can include grants to other charitable organizations. The amount that a private foundation must distribute annually is the "distributable amount," which is equal to the private foundation's minimum investment return with certain adjustments. If a private foundation does not make a distribution, § 4942(a) imposes a tax equal to 30 percent of the amount of the undistributed income each year. If a private foundation continues to fail to distribute the income, § 4942(b) imposes a second tax equal to 100 percent of the amount remaining that is undistributed. For purposes of meeting the above mandatory distribution requirements, a private foundation's distribution(s) must meet the definition of qualifying distribution in § 4942(g), which, in part, means any amount paid to accomplish one or more purposes described in § 170(c)(1) or (2)(B). Therefore, to meet the definition of qualifying distribution, your transfer of Property to Foundation must first meet the requirement that it is "any amount paid" to accomplish one or more exempt purposes. You transferred Property on Date with the understanding that, upon receipt, Foundation would demolish the office additions and restore the original design of the home, studio and landscape, which furthers its charitable purposes. Therefore, your transfer of Property to Foundation to accomplish charitable purposes meets the first requirement.

However, § 4942(g)(1)(A)(i) states that the term "qualifying distributions" does not include a distribution by a private foundation to an organization that is controlled, directly or indirectly, by one or more disqualified persons with respect to the foundation, except as provided in paragraph (3) of that section. The six trustees that control both you and Foundation are lineal descendants of your founders, who are substantial contributors described in § 4946(a), and thus, are disqualified persons described in § 4946(d) with respect to Foundation. Since you transferred Property to an organization that is controlled by disqualified persons, your distribution must meet the additional requirements set forth in paragraph (3) of § 4942(g) to meet the definition of "qualifying distribution".

Paragraph (3)(A) of § 4942(g) states that, for purposes of that section, the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization described in paragraph (1)(A)(i) if not later than the close of the taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution which is treated under subsection (h) as a distribution out of corpus. First, under § 53.4942-3(a)(5), Foundation's "qualifying distribution" was the conversion of Property back to the original design of the home, studio and landscape to further Foundation's charitable purpose. Second, Foundation satisfied the time requirement because the trustees effectively committed the Property to exempt use on Date, the same day you contributed it to Foundation. As a result, your

contribution and Foundation's conversion both took place serially on Date. Third, Foundation's qualifying distribution was equal to the amount of your contribution. Section 53.4942(a)-3(a)(1) states that the amount of a qualifying distribution of property is the fair market value of the property as of the date such qualifying distribution is made. Section 53.4942(a)-3(a)(5) states that the amount of a qualifying distribution of property is the fair market value of the converted asset as of the date of its conversion. Fourth, the distribution arising from the conversion is a distribution out of corpus as described in § 4942(h)(1), since Foundation had no undistributed income from prior years and its current distributions far exceed its income.

Finally, paragraph (3)(B) of § 4942(g) states that a private foundation making a qualifying distribution to another private foundation or controlled organization must obtain adequate records or other sufficient evidence from the recipient showing that qualifying distribution treated as a distribution out of corpus in the same amount has been made by the recipient. You met this requirement because you represent that Foundation provided you a written statement that it made sufficient qualifying distributions that were treated as distributions out of corpus before the end of its taxable year in which it received Property. You state further that Foundation has removed the two office buildings and the restoration of the Property to its original state.

Your transfer of Property to Foundation, followed by Foundation's conversion of Property to an exempt use, and Foundation's compliance with the reporting requirements of § 4942(g)(3) constitutes a qualifying distribution by you under § 4942.

Ruling 2:

The regulations state that if an asset not used or held for use by a private foundation directly in carrying out one or more purposes described in §170(c)(1) or (2)(B) is subsequently converted to such use, the foundation may treat such conversion as a qualifying distribution. See § 53.4942(a)-3(a)(5). Rev. Rul. 78-102, 1978-1 C.B. 379, held that the date of the decision to convert land to exempt purposes was the date the organization adopted a plan for the exempt use of the property and immediately proceeded to implement it. Accordingly, the date of conversion was the date the organization effectively committed the property to exempt use for purposes of treating the conversion as a qualifying distribution under § 53.4942(a)-3(a)(5). Therefore, the date of conversion by Foundation of Property was Date, the date the trustees effectively committed Property to exempt use for purposes of treating the conversion as a qualifying distribution under § 53.4942(a)-3(a)(5).

Accordingly, we rule that:

1. Your conveyance of Property to Foundation and the conversion of Property to an exempt use on Date constituted a qualifying distribution by you under § 4942(g)(3) in an amount equal to the fair market value of Property on Date.
2. The conversion of Property took place on Date, the date that, according to the plan, Foundation effectively committed Property to be used or held for use in carrying out its exempt purpose.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. § 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any § of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437